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No. 01-968

In the Supreme Court of the United States

NATIONAL ASSOCIATION OF STATE
UTILITY CONSUMER ADVOCATES, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Communications Commission may, consistent with 47 U.S.C. 254(k) (Supp. V 1999), authorize local telephone companies to recover all of the interstate-allocated costs of their loop facilities through charges imposed on their subscribers.

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OPINIONS BELOW

The decision of the court of appeals (Pet. App. 1a-27a) is reported at 265 F.3d 313. The order of the Federal Communications Commission (Pet. App. 28a-88a) is reported at 15 F.C.C.R. 12,962.

JURISDICTION

The judgment of the court of appeals was entered on September 10, 2001. The petition for a writ of certiorari was filed on December 10, 2001 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Communications Act of 1934, 47 U.S.C. 151 *et seq.*, as originally enacted, state public utility commissions generally regulated the rates and terms of intrastate telephone service, and the Federal Communications Commission (FCC) generally regulated the rates and terms of interstate service. 47 U.S.C. 152, 201; see *Louisiana Pub. Serv. Comm'n* v. *FCC*, 476 U.S. 355, 360 (1986); *National Ass'n of Regulatory Util. Comm'rs* (*NARUC*) v. *FCC*, 737 F.2d 1095 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1985). The same facilities of a local exchange carrier, or LEC, are used to provide both intrastate and interstate service. The costs of those facilities historically have been allocated between the federal and state jurisdictions. A regulatory authority considers only the costs allocated to its own jurisdiction when setting rates. See *NARUC*, 737 F.2d at 1104-1105.

This case concerns the most recent mechanism selected by the FCC to compensate local carriers for certain costs of originating and terminating interstate telephone calls. One key component of interstate access (as well as local service) is the loop, a wire that runs from the subscriber's premises to the local carrier's closest switching office. The cost of the loop to the local carrier is not traffic-sensitive; in other words, the cost does not vary whether a customer makes many calls or none at all, or whether the calls are local or long-distance. Traditionally, 25% of the cost of the loop has been allocated to the interstate jurisdiction. See Pet. App. 35a; *NARUC*, 737 F.2d at 1105.

The mechanism for compensating local carriers for the use of the loop and other components of their networks to make interstate telephone calls has varied

over time. For many years, AT&T, which maintained a virtual monopoly over long-distance service, paid all local carriers (including its wholly owned Bell Operating Companies) amounts sufficient to recover the portion of their costs that was allocated to the interstate jurisdiction. AT&T then recouped those payments through the rates it charged its customers for interstate and international long-distance service. See Pet. App. 28a, 31a-32a.

In 1983, after competition had developed in the long-distance market, the FCC adopted comprehensive rules to govern the rates that local carriers could charge for connecting their customers to AT&T and competing long-distance carriers, also referred to as interexchange carriers or IXCs. See Pet. App. 32a-36a.

With respect to the loop, the FCC allowed local carriers to impose a "Subscriber Line Charge" (SLC), a federally regulated fee assessed directly against their customers, to recover a portion of those loop costs that had been allocated to the interstate jurisdiction. The FCC explained that principles of economic efficiency and cost causation favored the choice of a flat fee, rather than a usage-sensitive fee, to recover those non-traffic-sensitive costs. Otherwise, if a customer who made many long-distance calls were required to pay more than a customer who made few long-distance calls, even though the fixed loop costs for those customers were the same, the demand for long-distance service would be artificially suppressed. Pet. App. 35a-36a, 40a; see *NARUC*, 737 F.2d at 1105 (observing that, when "local plant costs are recovered from long-distance fees paid by long-distance callers on a traffic-sensitive basis," "subscribers who are heavy long-distance users * * * pay a percentage of the costs of

the local network wholly out of proportion to the costs of supplying them with service").

At the same time, in response to concerns that local telephone service not be made unaffordable for customers who made few long-distance calls, the FCC placed caps on the SLC. The FCC perceived the caps as temporary restrictions that would eventually be lifted so that the SLC could be based on actual costs. In addition, the FCC established a per-minute charge, the Carrier Common Line Charge (CCL), so that local carriers could recover from long-distance carriers the interstate-allocated loop costs that, as a result of the caps, could not be recovered through SLCs. See Pet. App. 40a; see also *In re MTS & WATS Market Structure*, 93 F.C.C.2d 241, 290-296 (paras. 169-194) (1983); *NARUC*, 737 F.2d at 1135.

After a transitional period, the FCC set the SLC cap at $3.50 per month for residential lines and single-line business lines. As a result of that cap, most local carriers could not recover all of their loop costs allocated to the interstate jurisdiction through the SLC. Accordingly, local carriers continued to recover a significant portion of those costs from long-distance carriers through the per-minute CCL charges. The result was the continuation of a substantial implicit subsidy from high-volume users of long-distance service to residential and single-line business customers. See *In re Access Charge Reform* (*Access Charge Order I*), 12 F.C.C.R. 15,982, 15,994-15,995 (para. 28), 16,007-16,008 (para. 68) & n.61 (1997), aff'd *sub nom. Southwestern Bell Tel. Co.* v. *FCC*, 153 F.3d 523 (8th Cir. 1998). That implicit subsidy promoted "universal service"—the availability of affordable basic telephone service to all consumers, see Pet. App. 41a—which has long been one of the FCC's policy objectives. See *Texas Office of Pub.*

Util. Counsel (*TOPUC*) v. *FCC* 183 F.3d 393 (5th Cir. 1999), cert. dismissed, 531 U.S. 975 (2000).

2. In the Telecommunications Act of 1996 (1996 Act), Pub. L. No. 104-104, 110 Stat. 56, Congress "fundamentally restructure[d] local telephone markets." *AT&T* v. *Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999). Section 253 of the Act eliminates state-sanctioned monopolies in local telecommunications markets, and Sections 251 and 252 require incumbent carriers to take various steps to open their markets to competition. 47 U.S.C. 251-253.[1] See *Iowa Utils. Bd.*, 525 U.S. at 371-373.

In addition, Section 254 of the 1996 Act directs the FCC to establish an "explicit" system of universal service support to replace the existing system of implicit subsidies, which allowed carriers to charge above-cost rates to some customers (*e.g.*, business customers and residential customers in urban areas) so that they could charge below-cost rates to other customers (*e.g.*, residential customers in rural areas who are particularly expensive to serve). Section 254 reflects Congress's understanding that such implicit subsidies are incompatible with a competitive regime because, given a choice of local providers, customers would not elect to pay the above-cost prices that support traditional implicit subsidy mechanisms. See H.R. Rep. No. 204, 104th Cong., 1st Sess. 80 (1995) (recognizing the need to evaluate universal service mechanisms "in the context of a local market changing from one characterized by monopoly to one of competition").

In 1997, the FCC adopted rules for implementing Section 254. See *In re Federal-State Joint Bd. on*

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[1] Citations in this brief of provisions of the 1996 Act are of Supplement V 1999.

Universal Serv., 12 F.C.C.R. 8776 (1997), aff'd in part and rev'd in part, *TOPUC*, *supra*. Among other things, the FCC designated which services would be supported by the new federal universal service mechanism. As relevant here, those services include "[a]ccess to interexchange service," which the FCC defined as "the use of the loop, as well as that portion of the switch that is paid for by the end user, * * * necessary to access an interexchange carrier's network." 47 C.F.R. 54.101(a)(7).

3. In a separate proceeding, the FCC revised its access charge rules to reflect the changes in federal universal service support wrought by the 1996 Act. The FCC made clear that a local carrier must use its receipts from the new federal universal service mechanism to offset interstate access charges. See *Access Charge Order I*, 12 F.C.C.R. at 16,148 (para. 381). In other words, to the extent that a carrier received more in federal universal service support, the carrier could recover less in access charges.

The FCC took other steps to reduce the implicit universal service subsidy provided under its access charge regime. The FCC increased the SLC cap for multi-line business lines and non-primary residential lines so that, for many such lines, local carriers would recover all interstate-allocated loop costs solely through the SLC. *Access Charge Order I*, 12 F.C.C.R. at 16,012-16,014 (paras. 75-79).

At the same time, the FCC established the "Presubscribed Interexchange Carrier Charge" (PICC), a flat fee assessed against a customer's presubscribed long-distance carrier, to replace the CCL as a means for local carriers to recover those interstate-allocated loop costs that they could not recover through the SLC. The PICC made up for much, although not all, of the short-

fall between local carriers' interstate-allocated loop costs and the amounts that they recovered through the SLC. In some cases, however, local carriers recovered more than their interstate-allocated loop costs for multi-line business lines and non-primary residential lines because of the combination of the PICC and the increase in the SLC caps for those lines. Thus, as a practical matter, the PICCs assessed on those lines made up for some of the shortfall for single-line business lines and primary residential lines. *Access Charge Order I*, 12 F.C.C.R. at 16,019-16,024 (paras. 91-102). The FCC contemplated that this implicit subsidy would eventually become unnecessary as the SLCs and PICCs on single-line business lines and primary residential lines covered more of the interstate-allocated loop costs for those lines. *Id.* at 16,005 (para. 57).

The Eighth Circuit upheld the FCC's new access charge rules. *Southwestern Bell*, *supra*. In particular, the court of appeals held that the FCC's increase in the SLC caps for multi-line business lines and non-primary residential lines was consistent with 47 U.S.C. 254(k), which directs the FCC to "establish any necessary cost allocation rules, accounting safeguards, and guidelines" for interstate services "to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services." The court rejected the argument that the increase in the SLC caps violated Section 254(k) by imposing more than a reasonable share of joint and common costs on consumers of local telephone service. The court held that the increase in the SLC caps did not implicate Section 254(k), because Section 254(k) concerns cost allocation, not cost recovery, whereas "the SLC is a method of recovering loop costs, not an allocation of those costs

between supported and unsupported services." 153 F.3d at 558-559.

4. In 1999, while the FCC was engaged in several rulemaking proceedings regarding access charges and universal service, the Coalition for Affordable Local and Long Distance Service (CALLS) proposed to the FCC a comprehensive transitional regulatory plan concerning access charges and universal service. The members of CALLS include both local carriers and long-distance carriers, two groups that had been at odds over many aspects of telecommunications regulation under the 1996 Act. As modified, the CALLS plan provided, among other things, for an immediate elimination of PICCs for all residential lines and single-line business lines and a gradual increase in the SLC caps for primary residential lines and single-line business lines from $3.50 to $6.50. See Pet. App. 29a, 49a-50a.

After receiving public comment, the FCC adopted a modified version of the CALLS plan. The FCC concluded that the proposed increase in the SLC caps and elimination of the PICC "is in the public interest because it simplifies the current rate structure, moves towards cost-based rates, reduces consumers' overall rates, and simplifies long-distance bills, thereby resulting in less consumer confusion." Pet. App. 64a. In particular, the FCC observed that long-distance carriers, when passing along the PICC to their customers, imposed additional "transaction costs." *Id.* at 60a-61a; see *id.* at 68a ("the reality in the marketplace is that IXCs have marked-up and passed-through the PICC to end users"). The FCC thus concluded that consumers' "savings from the elimination of the [PICC] and the long-distance companies' pass-through of that

charge exceed the modest increases to the [SLC] that this plan allows." *Id.* at 30a.

In addition, the FCC concluded that 47 U.S.C. 254(k) was not implicated by the proposed increase in SLC caps and elimination of the PICC. Pet. App. 72a-78a. The FCC explained that "Section 254(k) is directed at the allocation of costs between competitive and non-competitive services, * * * and prohibits subsidization of competitive services by non-competitive services." *Id.* at 73a. In contrast, the FCC noted that "[t]he SLC is a method of recovering loop costs, not an allocation of those costs between supported and unsupported services." *Ibid.* The FCC further observed that "the SLC and PICC were established to recover loop costs for the same service—interexchange access," which is a "supported service" under its universal service rules. *Id.* at 77a. The FCC concluded that "moving the recovery of loop costs associated with interexchange access service from the PICC to the SLC is not a change in the allocation between supported and unsupported service," and thus is not the sort of change that might raise concerns under Section 254(k). *Id.* at 78a.

5. The Fifth Circuit affirmed in part and reversed in part. Pet. App. 1a-27a. As relevant here, the court of appeals held that the FCC was not precluded by 47 U.S.C. 254(k) from adjusting the mechanism for recovery of interstate-allocated loop costs by increasing SLC caps and eliminating the PICC. See Pet. App. 15a-16a.

The court of appeals recognized that Section 254(k) "concerns cost allocation of joint and common costs" between services that are, and are not, eligible for universal service support. Pet. App. 15a. Accordingly, the court concluded that, "[b]ecause the SLC is a method of recovering loop costs, not an allocation of

those costs between supported and unsupported services, § 254(k) is not implicated." *Ibid.* (quoting *Southwestern Bell*, 153 F.3d at 559).

In addition, the court of appeals characterized as "exaggerated" the claim that the FCC's adoption of the CALLS plan was "anti-consumer." Pet. App. 15a n.5. The court noted that under both the new scheme and its predecessors, end-users were required to pay access charges, "whether directly through the SLC or indirectly through the PICC or through a combination of both." *Id.* at 16a.

ARGUMENT

Petitioner challenges the FCC's modification of the mechanism for compensating local carriers for the portion of their loop costs associated with interstate telecommunications.[2] The FCC's action, which carefully balances multiple policy objectives, has received the support of all segments of the telecommunications industry. The FCC reasonably concluded, moreover, that its action would have no adverse impact on consumers, who have borne the entirety of interstate-allocated loop costs all along, and would have the potential to simplify and reduce their telephone bills.

Although petitioner contends that the FCC has violated 47 U.S.C. 254(k), that contention turns on a

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[2] Petitioner repeatedly suggests that the FCC's order in this case involves "all the costs of the loop." Pet. 13; see Pet. 12 ("all loop costs"); Pet. 14 ("all loop costs"); Pet. 17 ("100% of the cost of * * * the local loop"). In fact, the FCC's order involves only the 25% of loop costs allocated to the interstate jurisdiction. See Pet. App. 35a. State public utility commissions are not required to follow the FCC's approach in providing for the recovery of the 75% of loop costs allocated to the intrastate jurisdiction. See pp. 16-17, *infra*.

statutory construction that has been rejected by the FCC and by both courts of appeals that have considered it. Indeed, even if Section 254(k) could be construed to apply to cost-recovery mechanisms of the sort at issue here, the FCC's order would not violate Section 254(k), because it reasonably imposes interstate-allocated loop costs directly on the parties who cause them, the end-users of the telecommunications network. And, even if some state public utility commissions have taken a different approach to the recovery of intrastate-allocated loop costs, such differences have long been tolerated when the FCC and the state commissions each act within their own regulatory jurisdiction. For all of these reasons, this case does not warrant this Court's review.

1. Section 254(k) states:

> A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. *The Commission, with respect to interstate services,* and the States, with respect to intrastate services, *shall establish any necessary cost allocation rules,* accounting safeguards, and guidelines *to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.*

47 U.S.C. 254(k) (emphases added). Petitioner contends that the FCC violated the highlighted language by providing for local carriers to recover their interstate-allocated loop costs directly from their customers (through increased SLCs), rather than from long-distance carriers (through PICCs that are, in turn, passed on to their customers). As the court of appeals

recognized, however, the FCC's order does not even *implicate* Section 254(k). See Pet. App. 15a-16a. And, even if it did, the FCC's order would not *violate* Section 254(k), because there is nothing unreasonable about the FCC's decision to require the costs of the loop to be recovered directly from those who cause those costs, *i.e.*, the end-users of telephone service.

a. Section 254(k) was designed by Congress to address distinct concerns about carrier conduct that could undermine its goals of encouraging local telecommunications competition and safeguarding support for universal service. The first sentence of Section 254(k) prohibits carriers from "attempt[ing] to gain an unfair market advantage" by charging below-cost rates for competitive services and making up the shortfall by charging above-cost rates for services for which customers have no available alternative. Pet. App. 73a. The second sentence of Section 254(k) enforces that prohibition with respect to those basic non-competitive services that are eligible for universal service support. It also safeguards universal service by assuring that a carrier does not shift an excessive amount of its joint and common costs to services entitled to universal service support. *Id.* at 76a.

The FCC's order does not come within the text of Section 254(k) or raise the concerns that motivated it. That order does not involve the *allocation* of costs between supported and unsupported services (or between competitive and non-competitive services). It instead involves the *recovery* of loop costs for a single service, interstate access, which the FCC has previously determined to be a supported service. See 47 C.F.R. 54.101(a)(7). Section 254(k) has no application to the FCC's adjustments in the mechanism for the recovery of costs already allocated to a supported service.

See Pet. App. 76a-78a. Both the Fifth Circuit in this case and the Eighth Circuit in a challenge to the FCC's previous order increasing SLC caps agree with that understanding of Section 254(k). See *id.* at 15a-16a; *Southwestern Bell Tel. Co.* v. *FCC*, 153 F.3d 523, 559 (8th Cir. 1998). No court has held otherwise, as petitioner acknowledges (Pet. 19).[3]

Contrary to petitioner's assertions (Pet. 12), the second sentence of Section 254(k) is not "render[ed] * * * superfluous" if it is held not to apply to the FCC's order here. As the FCC recognized, that provision "places a continuing obligation on the Commission to ensure that the treatment of joint and common costs, such as corporate overheads, prescribed by our accounting, cost allocation, separations, and access charge rules will safeguard the availability of universal service." Pet. App. 76a. Thus, Section 254(k) applies to the FCC's allocation of carriers' joint and common costs among various interstate services, some of which are eligible for universal service support and some of which are not. *Ibid.*; see, *e.g.*, 47 C.F.R. 69.401-69.414.

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[3] Petitioner erroneously asserts (Pet. 14) that Section 254(k) "expressly requires the FCC to ensure that basic local service bears only a 'reasonable share' of network costs." Section 254(k) assigns responsibility to state public utility commissions, not the FCC, to adopt rules to assure that basic local service, a "service[] included in the definition of universal service," bears "no more than a reasonable share of the joint and common costs of facilities used to provide [that] service[]." The FCC's order has nothing to do with either the allocation of costs to basic local telephone service or the recovery of costs for providing such service. It instead deals with the recovery of the costs of interstate access service, which is a separate "service[] included in the definition of universal service."

At a minimum, the FCC's construction of Section 254(k), whether or not the *only* possible construction, is entirely reasonable. Accordingly, that construction is entitled to deference under *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 843-845 (1984). See *AT&T* v. *Iowa Utils Bd.*, 525 U.S. 366, 397 (1999) (noting the FCC's broad discretion in construing the general terms of the 1996 Act).

b. Even if Section 254(k) were understood to require that consumers bear no more than a reasonable share of interstate-allocated loop costs, it was not unreasonable for the FCC to require consumers to bear all of those costs. It has long been accepted that the consumer "causes" the costs of the loop. See, *e.g.*, Pet. App. 75a; *Southwestern Bell*, 153 F.3d at 558; *National Ass'n of Regulatory Util. Comm'rs* v. *FCC*, 737 F.2d 1095, 1113-1114 (D.C. Cir. 1984) (per curiam opinion of panel including Ginsburg, J.), cert. denied, 469 U.S. 1227 (1985). And, because the costs of the loop are not traffic-sensitive, the costs caused by a particular consumer do not vary depending on how many calls he or she makes. See *NARUC*, 737 F.2d at 1113 (recognizing that a consumer "causes" interstate-allocated loop costs by virtue of his or her "connection into the interstate network," whether or not that consumer "actually make[s] interstate calls"). The SLC requires con-sumers to pay only for the loop costs that they cause. Section 254(k), if applicable here at all, requires no more.

Petitioner nonetheless suggests (Pet. 17) that long-distance carriers use interstate access services and, therefore, should pay some of the costs of those services. In the first place, the SLC recovers only a portion of the costs of interstate access services, *i.e.*, the costs of the interstate-allocated portion of the loop. Other access components such as switching and

transport—which are essential to the origination or termination of any interstate call—continue to be charged to long-distance carriers, and not to consumers. More importantly, a long-distance carrier "uses" the loop and other components of interstate access services only if, and to the extent that, its customers make long-distance calls. It is end-users of the telecommunications network, not their long-distance carriers, that ultimately cause the costs associated with interstate access.

c. In any event, the FCC's order does not alter the portion of interstate-allocated loop costs ultimately borne by telecommunications consumers. As noted, the FCC found that long-distance carriers routinely "marked-up and passed-through the PICC to end users," so that consumers' overall rates were higher under the prior regime than they would be under the new regime. Pet. App. 68a. The FCC also found that even those consumers who did not presubscribe to a long-distance carrier faced those charges when they made a long-distance call. *Ibid.* Petitioner does not appear to dispute those findings.

Accordingly, the FCC concluded that charging consumers directly for all interstate-allocated loop costs through SLCs would not, as petitioner alleges (Pet. 19), operate "to the tremendous detriment of residential telephone customers." To the contrary, the FCC anticipated that its modification of the cost-recovery mechanism, in addition to its other benefits, would "reduce[] consumers' overall rates." Pet. App. 64a. It is the FCC's informed predictive judgments, not petitioner's bald assertions, that are entitled to substantial defer-

ence here. See, *e.g.*, *FCC* v. *National Citizens Comm. for Broad.*, 436 U.S. 775, 813-814 (1978).[4]

2. Petitioner also suggests (Pet. 23-29) that review is warranted to resolve a purported "conflict" between the application of Section 254(k) by the FCC and the federal courts of appeals and the application of Section 254(k) by state public utility commissions. To the extent that any such "conflict" exists, there is no need for this Court to resolve it.[5]

Under Section 254(k), regulatory jurisdiction over cost allocation is expressly divided: The FCC regulates the allocation of *inter*state costs, while state commissions regulate the allocation of *intra*state costs Thus, Congress clearly contemplated that federal and state regulators might adopt different approaches to cost allocation within their own regulatory spheres. See *Louisiana Pub. Serv. Comm'n* v. *FCC*, 476 U.S. 355, 375 (1986) (recognizing that, "once the correct allocation [of plant] between interstate and intrastate use has been made," the FCC and state commissions may "apply different rates and methods of depreciation").

Moreover, the asserted conflict, if any, in the application of Section 254(k) does not subject carriers to incompatible regulatory obligations. They may recover their interstate-allocated costs in accordance with the FCC's rules, while recovering their intrastate-allocated costs in accordance with the state commission's rules.

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[4] Because of the modifications of the FCC's Lifeline program also contained in the order under review, low-income consumers will not have to pay the increases in SLC rates. See Pet. App. 50a, 52a.

[5] Petitioner's claim of a conflict relies (Pet. 23), in part, on state commission decisions "before * * * the 1996 Act," and thus before the enactment of Section 254(k).

(Indeed, if the asserted conflict posed any significant problem for local carriers, they presumably would have opposed the FCC's order, instead of supporting it.) Consequently, even if federal and state approaches to cost allocation differ in this context, this Court's intervention is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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